

Report
of the
Examination of
Wausau Underwriters Insurance Company
Wausau, Wisconsin
As of December 31, 1999

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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February 5, 2001

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Commissioners:

In accordance with your instructions, a compliance examination has been made of
the affairs and financial condition of:

WAUSAU UNDERWRITERS INSURANCE COMPANY
Wausau, Wisconsin

and this report is respectfully submitted.

I. INTRODUCTION

The previous examination of the company was conducted in 1997 and 1998 as of
December 31, 1996. The current examination covered the intervening period ending
December 31, 1999, and included a review of such subsequent transactions as deemed
necessary to complete the examination.

The examination consisted of a review of all major phases of the company's operations and included the following areas:

- History
- Management and Control
- Corporate Records
- Conflict of Interest
- Fidelity Bonds and Other Insurance
- Employees' Welfare and Pension Plans
- Territory and Plan of Operations
- Affiliated Companies
- Financial Experience of the Company
- Reinsurance
- Financial Statements
- Accounts and Records
- Data Processing

Emphasis was placed on the audit of those areas of the company's operations accorded a high priority by the examiner-in-charge when planning the examination. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The section of this report titled "Summary of Examination Results" contains comments and elaboration on those areas where adverse findings were noted or where unusual situations existed. Comment on the remaining areas of the company's operations is contained in the examination work papers.

The company is annually audited by an independent public accounting firm as prescribed by s. Ins 50.05, Wis. Adm. Code. An integral part of this compliance examination was the review of the work papers prepared by the company's independent public accounting firm. Based on the results of the review of these work papers, alternative or additional examination steps deemed necessary for the completion of this examination were performed. The examination work papers contain documentation with respect to the alternative or additional examination steps performed during the course of the examination.

Actuarial Review by PricewaterhouseCoopers LLP

Since January 1, 1999, the company has been a participant in a reinsurance pooling agreement with Liberty Mutual Insurance Company and certain of its property and casualty insurance subsidiaries and other affiliates. The company's net loss and loss adjustment expense

reserves are the product of the reserves of the Liberty Mutual Group Pool and the company's participation percentage in the pool.

PricewaterhouseCoopers LLP, under contract with the Massachusetts Division of Insurance, reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves, as a function of its participation in the pool. The results of the firm's work were reported to the examiner-in-charge. As deemed appropriate, reference is made in this report to the actuarial firm's conclusion.

II. HISTORY AND PLAN OF OPERATION

Wausau Underwriters Insurance Company (hereinafter also “WUIC” and the “company”), a stock property and casualty company operating under ch. 611, Wis. Stat., is the ultimate successor to the Select Risk Mutual Insurance Company. Select Risk Mutual Insurance Company was incorporated under the laws of the state of Arkansas in August 1954. In 1959, Select Risk Insurance Company was incorporated in Arkansas to effect a conversion of Select Risk Mutual Insurance Company from a mutual company to a stock company. This conversion was completed on July 1, 1959. The corporate title of this predecessor company underwent numerous changes over its history. It was changed on October 1, 1959, to Southern Grange Insurance Company; on February 11, 1963, to VICO Insurance Company; on November 17, 1964, to Volkswagen Insurance Company; and on March 15, 1978, to Wausau Underwriters Insurance Company.

Wausau Service Corporation, a direct wholly owned subsidiary of EMPLOYERS INSURANCE OF WAUSAU A Mutual Company (hereinafter also “Employers”), purchased financial control of this predecessor company from VICO Corporation, of Englewood Cliffs, New Jersey, on December 30, 1977.

The present corporation itself was organized in Wisconsin on September 27, 1979, under the temporary title “Wausau Insurance Company A” to effect a change in the corporate domicile of WUIC from Arkansas to Wisconsin. On December 31, 1979, WUIC merged into Wausau Insurance Company A. This merger transaction dissolved the existence of the original WUIC as an independent entity and cancelled all of its issued and outstanding common stock. The surviving Wausau Insurance Company A changed its name to Wausau Underwriters Insurance Company on January 11, 1980.

On November 23, 1985, Employers consummated an affiliation agreement with Nationwide Mutual Insurance Company (hereinafter also “NMIC”) dated November 6, 1985. NMIC’s sister company, Nationwide Mutual Fire Insurance Company (hereinafter also “NMFIC”), was not a party to the affiliation agreement. Within the context of this agreement, and certain subsequent agreements, NMIC exercised control of Employers and its subsidiaries through

nomination of the various boards of directors, common executive management, and control of the reinsurance pool to which all direct premiums written by Employers are ceded and from which all net premiums written are assumed. The directors of Employers continued to be elected by the policyholders of Employers, as required by s. 611.53 (2), Wis. Stat. Election and reelection of nominees associated with NMIC on the Employers board preserved the affiliation.

The years of affiliation with NMIC resulted in considerable integration of the operations of Employers and NMIC, together with their respective subsidiaries and affiliates. The two insurers and many of their respective insurance subsidiaries, including WUIC, pooled their risks, and shared a program of external reinsurance on the pooled risks. The same persons held many of the senior executive positions of NMIC and Employers. Employers and its subsidiaries and NMIC and its subsidiaries provided numerous services to one another. The employees of Wausau Service Corporation received pension, medical, and other benefits from plans sponsored by NMIC.

In 1998, Nationwide Mutual Insurance Company decided to end its affiliation with Employers in order to focus greater attention on personal lines, particularly on promotion and service to its "First of America" brand of life insurance and investment products. The management of Employers searched for an affiliation in replacement that would provide the company with a means of severing its ties with NMIC in an orderly manner that preserved the continuity of quality service to policyholders and claimants.

On October 5, 1998, Employers entered into an Affiliation and Contribution Note Purchase Agreement with Liberty Mutual Insurance Company (hereinafter also, "Liberty Mutual") and a De-Affiliation Master Agreement with NMIC. The affiliation with Liberty Mutual was approved by OCI, following a public hearing, on December 16, 1998, and, under the terms of the agreement, became effective January 1, 1999. The disaffiliation with NMIC was approved in writing on December 16, 1998, and, under the terms of that agreement, became effective December 31, 1998. As part of the affiliation, Liberty Mutual purchased Wausau Insurance Company (U.K.) Limited and Wausau Service Corporation, together with the latter's subsidiaries, including Wausau Underwriters Insurance Company.

As of December 31, 1999, the company's capitalization included \$3,500,000 in the form of 8,750 common shares (of 10,000 authorized) with a par value of \$400 per share, and \$77,360,256 of paid-in and contributed surplus. The following schedule reflects the activity in capital stock and paid-in surplus since the incorporation of the company:

Year	Authorized Common Shares	Issued and Outstanding	Par Value Per Share	Gross Capital Paid Up	Gross Paid-In and Contributed Surplus
1979	0	0	N/A	\$ 0	\$21,690,256
1980	10,000	6,000	\$400	2,400,000	(230,000)
1982					(8,000,000)
1984		250		100,000	9,900,000
1985					10,000,000
1993		2,500		1,000,000	(1,000,000)
1995					20,000,000
1996					<u>25,000,000</u>
12/31/1999	<u>10,000</u>	<u>8,750</u>	<u>\$400</u>	<u>\$3,500,000</u>	<u>\$77,360,256</u>

The company has no employees of its own. All day-to-day operations are conducted with staff provided by Wausau Service Corporation and Liberty Mutual in accordance with the business practices and internal controls of those organizations. Virtually all expenses are initially paid by Employers. Expenses other than federal income taxes are allocated on the basis of specific identification, utilization estimates, and time studies, in conformity with a general expense allocation agreement. Tax allocations are established in accordance with a written consolidated federal income tax policy applicable to Liberty Mutual and certain of its direct and indirect subsidiaries. Intercompany balances with affiliates are created in the ordinary course of business with settlements generally made on a quarterly basis. Written agreements with affiliates are further described in the section of this report titled "Affiliated Companies."

WUIC's operations are coordinated from the home offices of Employers in Wausau, Wisconsin. Statutory accounting services are provided by employees of Liberty Mutual in Boston, Massachusetts. Support services are provided from a network of claim, legal, and marketing offices located throughout the United States.

In 1999, the company wrote business in every jurisdiction in which it is licensed in the United States, as well as in certain alien jurisdictions. The distribution of direct premiums written in 1999 by state or other jurisdictions was as follows:

Wisconsin	\$ 45,338,337	15.7%
Florida	19,522,050	6.8
California	16,123,855	5.6
Texas	14,373,939	5.0
Illinois	14,088,428	4.9
New York	14,068,299	4.9
Massachusetts	12,932,405	4.5
Other Alien	34,449	0.0
All Other U.S.	<u>152,672,377</u>	<u>52.8</u>
 Total	 <u>\$289,154,139</u>	 <u>100.0%</u>

As of the examination date, the company was licensed in all 50 U.S. states, the District of Columbia, and Puerto Rico.

In the state of Wisconsin, the company is licensed to transact the following lines of business as defined by s. Ins 6.75 (2), Wis. Adm. Code:

- (a) Fire, Inland Marine, and Other Property
- (b) Ocean Marine
- (c) Disability
- (d) Liability and Incidental Medical Expense
- (e) Automobile and Aircraft
- (f) Fidelity
- (g) Surety
- (j) Credit
- (k) Worker's Compensation
- (l) Legal Expense
- (n) Miscellaneous

The following table is a comparative summary of direct premiums written in 1996 and 1999, respectively:

Line of Business	1996 Premium	1996 Percent	1999 Premium	1999 Percent	Percent Change in Premium
Fire	\$ 411,517	0.1%	\$ 714,097	0.2%	73.5%
Allied lines	378,598	0.1	706,542	0.2	86.6
Homeowner's multiple peril	61,957	0.0	0	0.0	(100.0)
Commercial multiple peril	18,109,540	5.5	13,270,768	4.6	(26.7)
Inland marine	295,947	0.1	378,674	0.1	28.0
Earthquake	3,156	0.0	10,580	0.0	235.2
Worker's compensation	234,949,803	71.9	191,361,156	66.3	(18.6)
Other liability - occurrence	28,163,863	8.6	24,375,135	8.4	(13.5)
Products liability - occurrence	5,962,568	1.8	3,340,985	1.2	(44.0)
Private passenger auto liability	6,725,904	2.1	64,416	0.0	(99.0)
Commercial auto liability	22,404,581	6.8	44,439,205	15.4	98.3
Auto physical damage	9,717,938	3.0	10,431,744	3.6	7.3
Fidelity	16,139	0.0	34,729	0.0	115.2
Surety	33	0.0	899	0.0	2,624.2
Glass	559	0.0	0	0.0	(100.0)
Burglary and theft	12,029	0.0	11,130	0.0	(7.5)
Boiler and machinery	<u>20,493</u>	<u>0.0</u>	<u>14,078</u>	<u>0.0</u>	(31.3)
Total All Lines	<u>\$327,234,625</u>	<u>100.0%</u>	<u>\$289,154,139</u>	<u>100.0%</u>	(11.6)%

As of December 31, 1999, business was written through a sales force consisting of 146 account representatives and 2,577 independent agents.

Account representatives were employees of Wausau Service Corporation. Each received a salary, with the opportunity to earn a bonus, if remuneration credits, tallied much the same as commissions, exceeded salary and chargeable business expenses. If remuneration credits did not exceed salary and chargeable expenses, there was no chargeback, nor was the deficiency carried into the following year's compensation formula.

During 2000, account representatives ceased to produce business for the Wausau Insurance Companies and began to place business with Liberty Mutual Insurance Company and certain of its subsidiaries instead. The Wausau Insurance Companies were reconfigured to market business exclusively through independent agents.

Independent agents are compensated according to the following commission schedule. Some rates are on a sliding scale that declines with the volume of premium or service revenue related to a specific policy.

Product Line	Commission Rates
Worker's Compensation	5%
General Liability	15%
Auto	15%
Umbrella	15%
Packages	17%
Other Liability	Varies
Other Property	15%
Highly Protected Risks/ Property	
Special Risks	15%
Fidelity, Burglary, & Other Crime	15%
Plate Glass	10%
Contract Surety Bonds	5% to 30%
Other Surety Bonds	25%

III. MANAGEMENT AND CONTROL

Control by Succession of Parent Corporations

Liberty Mutual holds ultimate control of the company's board and of its executive direction. As more thoroughly described both previously and in Section IV of this report, all issued and outstanding common shares of the company are indirectly, but wholly, owned by Liberty Mutual. Liberty Mutual acquired Wausau Service Corporation and certain subsidiaries, including WUIC, pursuant to a Stock Purchase Agreement that was part of the affiliation arrangement with Employers.

Board of Directors

The board of directors consists of eight members. Directors are elected for three-year terms and are divided into three classes of expiry which are at, or as nearly possible at, one-third of the membership of the board. Members of the company's board of directors are typically members of other boards of directors in the holding company system. Certain senior officers are elected at the board's annual organizational meeting and as positions are created or fall vacant. Most of the company's officers are appointed by the officers elected by the board.

Directors who are members of executive management within the Liberty Mutual Group collect no compensation specific to their service on any board. Dwight E. Davis, the only director who is not currently a member of executive management, receives an annual stipend of \$10,000 per year, \$1,000 per year for service on each board committee, and \$1,250 for each regular or special meeting attended. This stipend compensates Mr. Davis for service on the following boards of directors: EMPLOYERS INSURANCE OF WAUSAU A Mutual Company, Wausau Business Insurance Company; Wausau General Insurance Company; and Wausau Underwriters Insurance Company. The stipend for attendance at meetings is calculated as if board meetings take place on a combined basis.

At the examination date, the board of directors consisted of the following persons:

Name and Residence	Principal Occupation	Term Expiry
J. Paul Condrin III Walpole, Massachusetts	Senior Vice President and Chief Financial Officer Liberty Mutual Insurance Company	2001
Terry L. Conner Rye, New Hampshire	Senior Vice President and Chief Information Officer Liberty Mutual Insurance Company	2002
Dwight E. Davis Mosinee, Wisconsin	Former President and Chief Operating Officer EMPLOYERS INSURANCE OF WAUSAU A Mutual Company	2002
A. Alexander Fontanes Duxbury, Massachusetts	Senior Vice President and Chief Investment Officer Liberty Mutual Insurance Company	2002
Gary R. Gregg Milton, Massachusetts	Executive Vice President Liberty Mutual Insurance Company	2003
Edmund F. Kelly Weston, Massachusetts	President and Chief Executive Officer Liberty Mutual Insurance Company	2001
Christopher C. Mansfield Dedham, Massachusetts	Senior Vice President and General Counsel Liberty Mutual Insurance Company	2003
James J. McIntyre Wausau, Wisconsin	President and Chief Operating Officer EMPLOYERS INSURANCE OF WAUSAU A Mutual Company	2001

* Mr. Davis was formerly President and Chief Operating Officer of EMPLOYERS INSURANCE OF WAUSAU A Mutual Company

Committees of the Board

Article IV of the company's bylaws permits the appointment of executive, nominating, investment, and audit committees, and allows the formation of such other committees as the board may desire. At the time of this examination, the board of directors appointed an audit committee and a compensation committee. Neither of the committees was active during the period under examination.

Audit Committee

The designation of an audit committee of not less than 3 directors is permitted by Article IV, Section 4, of the bylaws. The committee meets from time to time as necessary. It is

the function of this committee to maintain direct lines of communication between the board of directors and both the company's independent public accounting firm, and the internal audit department. The committee makes recommendations to the full board on the appointment of public accountants; reviews the financial statements of the company, its subsidiaries, and affiliates; inquires into the effectiveness of the company's internal auditing methods and procedures; and makes reports concerning its activities to the full board. Membership of the audit committee at the examination date was as follows: J. Paul Condrin III (Chairman), A. Alexander Fontanes, and Christopher C. Mansfield.

Compensation Committee

The compensation committee meets from time to time as its responsibilities may require; during the examination period. It is the function of this committee to research and issue recommendations to the board as a whole concerning director and senior executive compensation. Oversight is also extended to matters affecting retirement programs and employee benefit plans, succession plans, and personnel matters relating to high-level executives. Membership of the salary and compensation committee at the examination date was as follows: Edmund F. Kelly (Chairman), Gary R. Gregg, and James J. McIntyre.

Officers of the Company

The officers serving at the time of this examination are listed below.

Name	Office	1999 Compensation	
		Salary	Bonus
Edmund F. Kelly	Chairman of the Board and Chief Executive Officer	\$950,000	\$1,500,000
Gary R. Gregg	Vice Chairman	525,000	181,000
James J. McIntyre	President and Chief Operating Officer	225,000	81,000
J. Stanley Hoffert	Vice President, General Counsel, and Secretary	224,000	66,000
Elliot J. Williams	Vice President and Treasurer	190,000	49,000
Robert D. Effinger	Senior Vice President and Chief Actuary	155,000	0

Harold W. Larson	Senior Vice President, Custom Accounts Marketing	137,000	32,000
Edward W. Hancock	Vice President and Director, International Operations	140,000	45,000
Gary J. Ostrow	Vice President, Corporate Taxation	200,000	0
W. Craig Olafsson	Assistant Secretary	120,000	17,000
James Pugh	Assistant Secretary	108,000	0
Lawrence H. S. Yahia	Assistant Secretary	200,000	100,000
Richard Cloran	Assistant Treasurer	123,000	61,000
Lynn A. Theilig	Assistant Secretary	61,000	0

IV. AFFILIATED COMPANIES

Wausau Underwriters Insurance Company is a member of the Liberty Mutual Group, a multinational holding company system under the dual control of Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company (LMFIC). A chart of the companies within the holding company system is presented later in this section of the examination report.

WUIC is part of a distinct holding company subsystem within the Liberty Mutual Group, commonly known as the Wausau Insurance Companies. The Wausau Insurance Companies' marketing emphasis is on middle market and small business commercial risks solicited through independent agents. EMPLOYERS INSURANCE OF WAUSAU A Mutual Company exercises a leadership role within the Wausau Insurance Companies holding company subsystem. Employers does not own any subsidiaries, nor does it exercise "control" of any affiliate as that term is defined by s. 601.01(13), Wis. Stat. Its leadership role exists by virtue of its position as the largest member of that holding company subsystem. As of December 31, 1999, the Wausau Insurance Companies consisted of 25 entities, including 6 property and casualty insurers, 2 health maintenance organizations, 13 insurance brokerages or agencies, 3 providers of ancillary insurance services, and a holding company.

Present Succession of Control

WUIC is a third-tier affiliate of Liberty Mutual. Each entity in the immediate succession of control is described below, beginning with the ultimate parent and progressing to the next immediate tier of control.

Liberty Mutual Insurance Company

Liberty Mutual Insurance Company was incorporated under the laws of the Commonwealth of Massachusetts on January 1, 1912, and commenced business on July 1, 1912. The incorporator was Liberty Mutual Fire Insurance Company, which advanced all of the organizational expenses and initial financing.

Liberty Mutual is a diversified property and casualty insurer of commercial and personal lines, with distribution primarily by independent agents who confine their representation exclusively to companies in the Liberty Mutual Group. The company is licensed in all 50 U.S.

states, the District of Columbia, Puerto Rico, the U.S. Virgin Islands, Canada, and in various other foreign countries. Headquarters are maintained in Boston, Massachusetts.

As of December 31, 1999, Liberty Mutual reported assets of \$19,879,383,812, liabilities of \$14,329,938,118, policyholders' surplus of \$5,549,445,693, and net income of \$173,094,256. Liberty Mutual was examined concurrently with WUIC as of December 31, 1999, and the results of that examination were expressed in a separate report issued by the Massachusetts Division of Insurance.

Wausau Service Corporation

Wausau Service Corporation was incorporated under the laws of the state of Wisconsin as the "Wausau Insurance Finance Corporation" on September 21, 1959. It was initially organized to finance insurance premiums, a function that had been handled through the Insurance Finance Company, an independently owned corporation. Within only a few years, with the introduction of company installment plans, the corporation's original purpose became largely obsolete. From 1964 to the formation of Countrywide Services Corporation in 1971, WSC provided loss adjustment, safety, and health services to self-insured accounts on behalf of the Wausau Insurance Companies. Thereafter, for a time, the corporation essentially fell dormant. Then, in late 1977, it was decided to reactivate WSC as a downstream holding company. On November 18, 1977, WSC's board of directors voted to accept transfer of ownership from EMPLOYERS INSURANCE OF WAUSAU A Mutual Company (then known as Employers Mutual Liability Insurance Company of Wisconsin) of the capital stock of all affiliates except Wausau Insurance Company (U.K.) Limited (then known as Employers of Wausau (U.K.) Ltd.) effective January 2, 1978. On December 31, 1998, pursuant to a Stock Purchase Agreement dated October 5, 1998, Wausau Service Corporation, together with certain of its subsidiaries, was sold to Liberty Mutual.

As of December 31, 1999, the corporation reported assets of \$226,708,000, liabilities of \$39,937,000, stockholders' equity of \$186,771,000, and a net income of \$1,383,000.

Written Agreements with Affiliates

As previously noted, WUIC has no employees of its own. All operations are conducted by employees of WSC and Liberty Mutual in accordance with the business practices and internal controls of those organizations. In addition to ongoing common management and control by these upstream affiliates, various written agreements and undertakings affect the company's relationship to its affiliates. Reinsurance agreements are described in the reinsurance section of this report. A brief summary of the other agreements follows:

Liberty Mutual Insurance Company

Management Agreement

WUIC and Liberty Mutual entered into a Management Agreement effective January 1, 2000. Under this agreement, Liberty Mutual is to provide all services essential to the day-to-day operation of WUIC as requested by WUIC. WUIC is to reimburse Liberty Mutual a percentage of the total reasonable expenses, costs, losses, and disbursements, excluding claim payments, incurred by Liberty Mutual in its operation and in the operation of its subsidiaries. This allocation percentage is to be consistent with WUIC's customary cost allocation practices and is to be supported by WUIC's current expense allocation model, which model substantially complies with statutory accounting guidelines promulgated by the National Association of Insurance Commissioners. Settlements of fees and expenses are to be made within 45 days of the end of each calendar quarter.

Either party may terminate this agreement at any time with 90 days' written notice to the other. Only 45 days' notice is required in the event of the insolvency of either party. Liberty Mutual may terminate the contract immediately if WUIC fails to make payment of fees and expenses and such failure has not been cured within 30 days after the due date, or if WUIC's participation in the Liberty Mutual Group Pool is terminated and WUIC is no longer affiliated with the Liberty Mutual Group. In the event of termination, Liberty Mutual shall continue to provide such services for a period of time that is reasonably necessary to transfer service responsibilities to a new party.

Reciprocal Claims Service Agreement

Effective February 14, 2000, WUIC entered into a Reciprocal Claims Service Agreement with Liberty Mutual and other members of the Liberty Mutual Group to facilitate a combination of surety and fidelity claim operations under the control of Liberty Mutual. Under this agreement, Liberty Bond Services, a division of Liberty Mutual directs and supervises the fidelity and surety claim operations of all parties to the agreement. Each party appoints the others as its authorized agent, and grants each such party authority to act in its name and in its stead with respect to fidelity and surety claims. Each such party shall serve as the trustee and fiduciary of the others in servicing claims under the agreement. All parties agree to keep parties to this agreement fully advised of work performed on behalf of the others pursuant to reporting guidelines established by Liberty Bond Services. Each party to the agreement continues to remain responsible for payment of their own unallocated loss adjustment expenses. Allocated loss adjustment expenses and loss expenses incurred remain the responsibility of the party that underwrote the bond or policy. Parties to the agreement agree to preserve the confidentiality of information to which they receive access under this agreement and agree to use such information solely as directed by Liberty Bond Services for the performance of this agreement.

Tax Sharing Policy Memorandum

The Liberty Mutual Group had a tax sharing policy memorandum dated July 30, 1990. The principal elements within this tax policy memorandum may be summarized as follows:

- Beginning with the 1989 tax year, each company in the Liberty Mutual Group is to compute its taxes as if it were a stand-alone entity.
- Each entity will be reimbursed for net operating losses, capital losses, and tax credits if and when and only to the extent that they are used by the consolidated group. Credit will not be given for net operating losses, capital losses, and tax credits that expire unutilized on a separate company basis.
- Tax rates used in computing the separate company tax liability are the regular corporate rates for the regular, capital gains, alternative minimum, and environmental tax in effect at the

time the income is earned or, in the case of carryovers or carrybacks, at the rates in effect for the period in which the income against which the tax attribute is used was earned.

- Interest and penalties assessed against the Liberty Mutual Group as a result of a state or IRS audit will be assessed to the separate company from which the adjustment came.
- Each entity is to be provided a statement of the amount it is due or the amount owed within 45 days of the date of filing the consolidated return. Payments of amounts owed are due within 30 days' following receipt of the statement of balances. Late payments will carry an interest charge at the federal rate on tax deficiencies from the date of the original billing.

Wausau Service Corporation

WUIC entered into a Management Agreement with Wausau Service Corporation effective December 31, 1998, which was amended effective January 1, 2000. The terms of this agreement are largely the same as those of the Management Agreement with Liberty Mutual. This agreement was amended to terminate the exclusivity of Wausau Service Corporation's appointment as a provider of management services. The employees that provide services to the Wausau Insurance Companies are in the midst of a comprehensive reorganization to integrate them into the Liberty Mutual Group, and thereby eliminate the duplication of services and take advantage of the respective organizations' strengths. The employees of Wausau Service Corporation that are anticipated to remain after the reorganization are gradually being reassigned to Liberty Mutual. Eventually, Wausau Service Corporation will not have any employees. Provisions for the curtailment and addition of services were added to the agreement to facilitate this transition. In the event of any conflict or inconsistency between the provisions of the management agreement with Liberty Mutual and the management agreement with Wausau Service Corporation, the conflict or inconsistency will be resolved in favor of the provisions of the contract with Liberty Mutual.

Liberty Mutual Investment Advisors LLC

Cash Management Agreement

WUIC entered into a Cash Management Agreement with Liberty Mutual Investment Advisors LLC dated January 28, 2000. Under this agreement, Liberty Mutual Investment

Advisors LLC manages an investment pool on behalf of participating members of the Liberty Mutual Group, investing and reinvesting funds contributed by the members in short-term obligations of banks, corporations, and the U.S. and Canadian federal governments with a maximum duration of 365 days from the date of purchase. The investment pool functions in a manner analogous to a short-term bond mutual fund. A participant may terminate the agreement at the end of any business day upon prior written notice to the manager, or at any time by Liberty Mutual Investment Advisors LLC upon 30 days' written notice to the company. If the company should ever become insolvent, the company's statutory successor in interest could withdraw all or any portion of the company's proportionate share of the assets in the investment pool.

Investment Management Agreement

Effective May 1, 2000, WUIC entered into an investment management agreement with Liberty Mutual Investment Advisors LLC. Under this agreement, Liberty Mutual Investment Advisors LLC is to act as the company's agent and attorney-in-fact with respect to its investment portfolio. Subject to the WUIC's board of directors and investment guidelines, Liberty Mutual Investment Advisors LLC has complete day-to-day discretionary control, including the power to make acquisitions and disposals of investments, and issue instructions to brokers and custodians. Liberty Mutual Investment Advisors LLC is to be reimbursed for all custody related charges and wire transfer fees related to the account, including, but not limited to, commission expenses and transaction fees imposed by the U.S. Securities and Exchange Commission. Liberty Mutual Investment Advisors LLC is to receive a monthly management fee equivalent to 3.4 basis points on an annualized basis. In the event that compensation is determined to be unfair and unreasonable in relation to actual expenses incurred in managing the account, the amount of compensation will be adjusted by mutual agreement.

The agreement is to be construed in accordance with applicable federal law and, to the extent not preempted, the laws of the State of Wisconsin. Liberty Mutual Investment Advisors LLC may terminate this agreement at any time upon 90 days' advance written notice. WUIC may terminate this agreement at any time upon written notice to Liberty Mutual Investment Advisors

LLC, but Liberty Mutual Investment Advisors LLC shall have a reasonable time, not to exceed 90 days, to transfer assets to a custodian selected by Employers.

Liberty Mutual Capital Corporation

WUIC, together with its affiliates, Employers, Wausau Service Corporation, Wausau Business Insurance Company, and Wausau General Insurance Company, entered into a Revolving Loan Agreement with Liberty Mutual Capital Corporation as of December 31, 1998. Under this agreement, Liberty Mutual Capital Corporation agrees to provide Employers and its specified affiliates, collectively, with a line of credit of up to \$50,000,000. Loans under the agreement must be in a minimum principal amount of \$25,000 and in integral multiples of \$25,000, as the borrowers may specify, up to but not exceeding the \$50,000,000 aggregate line of credit. The current balances of loans to each borrower are to be evidenced by a single note from each borrower. The obligations of each borrower are several and not joint, that is, each borrower is solely responsible for its own loan balance and related obligations and not those of any other borrower utilizing the aggregate line of credit. The rate of interest is based on the short-term funding facilities of Liberty Mutual and Liberty Mutual Capital Corporation, but in no event to exceed the average prime rate published from time to time in the Wall Street Journal plus 5% per annum.

Wausau Insurance Companies

Expense Allocation Agreement

WUIC entered into an expense allocation agreement with Employers and its other affiliates effective January 1, 1992. These companies share various administrative services, office facilities, and equipment, with expenses being apportioned among the applicable member/user companies.

Temporary Help Agencies Producer Agreement

The members of the Wausau Insurance Companies are party to a Temporary Help Agencies Producer Agreement among themselves and with Yunker Innovative Options, Inc. effective August 1, 1996, to provide temporary help service for the placement of certain insurance

business produced by Yunker Innovative Options, Inc. and agencies affiliated with the Wausau Insurance Companies.



V. REINSURANCE

The company participates in a pooling arrangement with certain of its affiliates. The pool participants cede 100% of their net premiums written, losses, loss adjustment expenses, and underwriting expenses to Liberty Mutual Insurance Company. Liberty Mutual, as the lead company and pool manager, administers all aspects of the pooled business, including placement of reinsurance with nonaffiliated insurers. The net pooled business is then distributed according to the participations listed below. Income and expenses related to investment operations and corporate taxes, including federal income taxes, are not included in pooling.

WUIC cedes premiums to certain affiliated and nonaffiliated insurers before pooling, so that the pool is insulated from exposure on certain risks. WUIC assumes premiums from certain affiliated and nonaffiliated insurers before pooling, so that the pool thereby assumes certain other risks. In addition to reinsurance that WUIC assumes and cedes for its own account prior to pooling, WUIC receives protection from the reinsurance that Liberty Mutual obtains on behalf of the Liberty Mutual Pool.

All voluntary contracts reviewed by examiners contained proper insolvency provisions. Involuntary arrangements, such as state auto insurance facilities, mine subsidence funds, and other involuntary excess funds have provisions deemed appropriate by the governmental authorities that establish and administer them. Significant treaties are summarized as follows.

Affiliated Pooling Agreement

Participations:

	1/1/99	1/1/00
Liberty Mutual Insurance Company	65.95%	63.00%
EMPLOYERS INSURANCE OF WAUSAU		
A Mutual Company	13.00%	16.00%
Liberty Mutual Fire Insurance Company	10.00%	10.00%
Liberty Insurance Corporation	6.00%	6.00%
Golden Eagle Insurance Corporation	2.50%	2.50%
Montgomery Mutual Insurance Company	0.70%	0.70%
Wausau Business Insurance Company	0.40%	0.40%
Wausau General Insurance Company	0.40%	0.40%
Wausau Underwriters Insurance Company	0.40%	0.40%
Merchants and Business Men's Mutual Insurance Company	0.25%	0.20%

LM Insurance Corporation	0.20%	0.20%
Montgomery Indemnity Company	0.10%	0.10%
The First Liberty Insurance Corporation	0.10%	0.10%

100% Quota Share Affiliated Companies:

Liberty Lloyds of Texas Insurance Company	0.00%	0.00%
Liberty Insurance Company of America	0.00%	0.00%
Liberty Personal Insurance Company	0.00%	0.00%
Liberty Surplus Insurance Corporation	0.00%	0.00%
Liberty Insurance Underwriters, Inc.	0.00%	0.00%
Colorado Casualty Insurance Company	0.00%	0.00%
Bridgefield Employers Insurance Company	0.00%	0.00%
Bridgefield Casualty Insurance Company	0.00%	0.00%

Total Liberty Mutual Group Pool	100.00%	100.00%
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Lines Covered:	All
Items Included:	Losses, loss adjustment expenses, underwriting expenses, salvage and subrogation recoveries, assessments, taxes, and policyholder dividends
Effective:	January 1, 1999, as amended effective January 1, 2000
Termination:	At any time with 120 days' written notice by any party. Each participant shall remain liable with respect to all cessions in force on the effective date of termination.
Additional Comments:	Any dispute arising out of this agreement shall be settled through arbitration. Canadian business participations are limited to Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company, which have 90% and 10% participation, respectively.

Other Ceding Reinsurance

The company is a direct co-party to the following ceded reinsurance agreements, which have been summarized in detail in the concurrent examination report of EMPLOYERS INSURANCE OF WAUSAU A Mutual Company.

Type of Reinsurance	Effective Date	Termination Date
<u>Pre-Pool Reinsurance Program</u>		
100% Quota Share on Discontinued Operations with Nationwide Indemnity Company	12/31/1998	Continuous
Commercial Insurance Group Property Underlying Per Risk Excess of Loss Reinsurance Contract	09/01/1999	09/01/2000
Property Automatic Facultative Reinsurance Agreement	07/01/1999	Continuous

Type of Reinsurance	Effective Date	Termination Date
<u>Pre-Pool Reinsurance Program (continued)</u>		
Special Surplus Reinsurance Contract	01/01/1998	01/01/1999
Three-Layer Property Per Risk Excess of Loss	07/01/1999	07/01/2000
Four-Layer Property Catastrophe Excess of Loss	07/01/1999	07/01/2000
Highly Protected Risk/Property Special Risk Aggregate Excess of Loss	01/01/1999	01/01/2001
Two-Layer Casualty Buffer Agreement	07/01/1999	07/01/2000
Four-Layer Casualty Excess of Loss	07/01/1999	07/01/2000
Worker's Compensation per Claimant Excess of Loss Agreement	07/01/1999	07/01/2000
Three-Layer Worker's Compensation Excess of Loss	07/01/1999	07/01/2000
Employment Related Practices Liability Quota Share	04/01/1999	04/01/2000
Commercial Umbrella Liability First Excess of Loss	01/01/1985	Continuous
Commercial Umbrella Liability Second Excess of Loss	08/15/1990	Continuous
<u>Liberty Mutual Pool Reinsurance Program</u>		
Three-Layer Property Catastrophe Excess of Loss	01/01/1999	01/01/2000
Underlying Property Per Risk Excess of Loss	01/01/1999	01/01/2000
Three-Layer Property Per Risk Excess of Loss	01/01/1999	01/01/2000
Four-Layer Casualty Excess of Loss	01/01/1999	01/01/2000
Workers' Compensation Excess of Loss	01/01/1999	01/01/2000
Two-Layer Workers' Compensation Catastrophe Excess of Loss	01/01/1999	01/01/2000
Truck Casualty Automatic Excess of Loss	07/01/1999	07/01/2000

VI. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported in the December 31, 1999, annual statement to the Commissioner of Insurance. Adjustments made as a result of the examination are noted in the section of this report captioned "Reconciliation of Policyholders' Surplus." Also included in this section are schedules which reflect the financial experience of the company, the compulsory and security surplus calculation, and NAIC Insurance Regulatory Information System (IRIS) ratio results for the period under examination.

Wausau Underwriters Insurance Company
Assets
As of December 31, 1999

	Ledger Assets	Nonledger Assets	Nonadmitted Assets	Admitted Assets
Bonds	\$145,694,963	\$	\$	\$145,694,963
Stocks:				
Common stocks	224,555	(10)		224,545
Cash	9,736			9,736
Short-term investments	22,866,893			22,866,893
Receivable for securities	808,165			808,165
Write-ins for invested assets:				
1994 private passenger auto escrow amounts – 2/1/94	17,084			17,084
December 1996 private passenger auto filing escrow accounts	3,536			3,536
Agents' balances or uncollected premiums:				
Premiums and agents' balances in course of collection	2,004,191		379,157	1,625,034
Premiums, agents' balances, and installments booked but deferred and not yet due	3,951,982		31,000	3,920,982
Accrued retrospective premiums		2,445,525	247,622	2,197,903
Bills receivable, taken for premiums	380		380	
Reinsurance recoverables on loss and adjustment payments	792,343			792,343
Guaranty funds receivable or on deposit	11,161			11,161
Interest, dividends, and real estate income due and accrued		2,323,982		2,323,982
Write-ins for other than invested assets				
Amounts receivable under uninsured plans	899,785		39,630	860,155
Other assets	450,006		295,506	154,500
Funds deposited with reinsurers	<u>12,595,249</u>	<u> </u>	<u>0</u>	<u>12,595,249</u>
Total Assets	<u>\$190,374,267</u>	<u>\$4,769,786</u>	<u>\$994,908</u>	<u>\$194,149,145</u>

Wausau Underwriters Insurance Company
Liabilities, Surplus, and Other Funds
As of December 31, 1999

Losses	\$51,132,523
Loss adjustment expenses	10,453,511
Contingent commissions and other similar charges	24,904
Other expenses (excluding taxes, licenses, and fees)	941,212
Taxes, licenses, and fees (excluding federal and foreign income taxes)	183,311
Federal and foreign income taxes (excluding deferred taxes)	1,436,070
Unearned premiums	9,081,101
Dividends declared and unpaid:	
Policyholders	151,071
Amounts withheld or retained by company for the account of others	837,290
Provision for reinsurance	1,261,100
Drafts outstanding	1,159,890
Payable to parent, subsidiaries, and affiliates	45,825,970
Payable for securities	376,928
Write-ins for liabilities:	
Amounts held under uninsured plans	1,058,658
Other liabilities	1,551,399
1994 private passenger auto escrow amounts – 2/1/94	17,084
December 1996 private passenger auto filing escrow accounts	<u>3,536</u>
 Total Liabilities	 125,495,558
 Common capital stock	 3,500,000
Gross paid in and contributed surplus	77,360,256
Unassigned funds (surplus)	(12,206,669)
 Surplus as Regards Policyholders	 <u>68,653,587</u>
 Total Liabilities, Surplus, and Other Funds	 <u>\$194,149,145</u>

Wausau Underwriters Insurance Company
Summary of Operations
For the Year 1999

Underwriting Income

Premiums earned \$27,617,608

Deductions

Losses incurred 20,711,275
 Loss expenses incurred 4,696,888
 Other underwriting expenses incurred 6,774,490
 Write-ins for underwriting deductions:
 Other underwriting deductions (125,971)

Total underwriting deductions 32,056,682

Net underwriting gain or loss (4,439,074)

Investment Income

Net investment income earned 14,217,085
 Net realized capital gains or losses 3,069,073
 Net investment gain or loss 17,286,158

Other Income

Net gain or loss from agents' or premium balances charged off (148,038)
 Finance and service charges not included in premiums 159,543
 Write-ins for miscellaneous income:
 Miscellaneous income/expense (287,665)
 Total other income (276,160)

Net income before dividends to policyholders and
 before federal and foreign income taxes 12,570,924
 Dividends to policyholders 463,754

Net income after dividends to policyholders but
 before federal and foreign income taxes 12,107,170
 Federal and foreign income taxes incurred 2,779,806

Net Income \$ 9,327,364

Wausau Underwriters Insurance Company
Cash Flow
For the Year 1999

Premiums collected net of reinsurance	\$ 65,498,016	
Loss and loss adjustment expenses paid (net of salvage or subrogation)	517,149,563	
Underwriting expenses paid	28,362,029	
Other underwriting income/expenses	<u>183,524</u>	
Cash from underwriting		\$(479,830,052)
Net investment income		18,047,778
Other income (expenses):		
Agents' balances charged off	(148,038)	
Net amount withheld or retained for account of others	(2,116,193)	
Write-ins for miscellaneous items:		
Other income/expense	<u>50,947</u>	
Total other income		<u>2,213,284</u>
Deduct:		
Dividends to policyholders paid	1,777,148	
Federal income taxes (paid) recovered	<u>(14,152,104)</u>	
Net cash from operations		(479,924,810)
Proceeds from investments sold, matured, or repaid:		
Bonds	<u>183,921,298</u>	
Total investment proceeds		183,921,298
Cost of investments acquired (long-term only):		
Bonds	<u>57,014,689</u>	
Total investments acquired		<u>57,014,689</u>
Net cash from investments		126,906,609
Cash provided from financing and miscellaneous sources:		
Net transfers from affiliates	279,320,855	
Other cash provided	<u>31,033,632</u>	
Total		310,354,487
Net cash from financing and miscellaneous sources		<u>310,354,487</u>
Net change in cash and short-term investments		(42,663,714)
Reconciliation:		
Cash and short-term investments, January 1, 1999		<u>65,540,343</u>
Cash and short-term investments, December 31, 1999		<u>\$ 22,876,629</u>

**Wausau Underwriters Insurance Company
Compulsory and Security Surplus Calculation
December 31, 1999**

Assets		\$194,149,145	
Less investment in insurance subsidiaries not in excess of subsidiaries' security surplus		-0-	
Add net examination adjustments*		1,295,723	
Less liabilities		<u>125,495,558</u>	
Adjusted surplus			\$69,949,310
Annual premium:			
Individual accident and health	\$ 268,334		
Factor	<u>15%</u>		
Total		40,250	
Group accident and health	1,602,548		
Factor	<u>10%</u>		
Total		160,255	
All other insurance	12,566,960		
Factor	<u>20%</u>		
Total		<u>2,513,392</u>	
Compulsory surplus (subject to a minimum of \$2 million)			<u>2,713,897</u>
Compulsory surplus excess (or deficit)			<u>\$67,235,413</u>
Adjusted surplus			69,949,310
Security surplus:			
(140% of compulsory surplus, factor reduced 1% for each \$33 million in premium written in excess of \$10 million with a minimum of 110%)			<u>3,799,456</u>
Security surplus excess (or deficit)			<u>\$66,149,854</u>

* These consist of the adjustments of the examination report as shown under the caption "Reconciliation of Policyholders' Surplus." Accordingly, the compulsory and security surplus excesses reflected in this schedule differ from the figures reported by the company in its supplementary filing with the 1999 annual statement.

Wausau Underwriters Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Three-Year Period Ending December 31, 1999

The following schedule is a reconciliation of total surplus during the period under examination as reported by the company in its filed annual statements:

	1997	1998	1999
Surplus, beginning of year	\$72,508,133	\$81,495,412	\$60,391,024
Net income	10,882,219	(15,266,903)	9,327,364
Net unrealized capital gains or (losses)	(228,352)	8,807	224,523
Change in nonadmitted assets	1,765	(8,145,793)	9,284,183
Change in provision for reinsurance	(136,375)	(698,045)	299,861
Change in excess of statutory reserves over statement reserves	(1,061,000)	1,567,000	31,000
Write-ins for gains and losses in surplus:			
Discontinued business surplus adjustment	(225,912)	(238,112)	0
Accounts payable	(245,066)	1,668,658	0
Other surplus items	0	0	(10,899,106)
Change in accumulated translation adjustment	<u>0</u>	<u>0</u>	<u>(5,262)</u>
Change in surplus as regards Policyholders for the year	<u>8,987,279</u>	<u>(21,104,388)</u>	<u>8,262,563</u>
Surplus, end of year	<u>\$81,495,412</u>	<u>\$60,391,024</u>	<u>\$68,653,587</u>

Insurance Regulatory Information System
For the Three-Year Period Ending December 31, 1999

The following is a summary of NAIC Insurance Regulatory Information System (IRIS) results for the period under examination. Exceptional ratios are denoted with asterisks. A discussion of the exceptional ratios may be found after the IRIS ratios.

Ratio	1997	1998	1999
#1 Gross Premium to Surplus	552%	728%	487%
#1A Net Premium to Surplus	209	193	22
#2 Change in Net Writings	(16)	(32)	(87)*
#3 Surplus Aid to Surplus	0	0	0
#4 Two-Year Overall Operating Ratio	96	99	106*
#5 Investment Yield	6.6	6.7	5.7
#6 Change in Surplus	11	(26)*	7
#7 Liabilities to Liquid Assets	85	174*	72
#8 Agents' Balances to Surplus	5	47*	4
#9 One-Year Reserve Development to Surplus	(3)	(6)	(1)
#10 Two-Year Reserve Development to Surplus	3	(9)	(2)
#11 Estimated Current Reserve Deficiency to Surplus	12	(99)	11

The exceptional value for Ratio #6, "Change in Surplus," in 1998 of (26)% reflects the net loss experienced in that year as well as the fact that for a brief moment in time coinciding with the close of business on December 31, 1998, the company was not a member of any reinsurance pool.

The exceptional values for Ratio #7, "Liabilities to Liquid Assets," and Ratio #8, "Agents' Balances to Surplus" in 1998 of 174% and 47%, respectively, were attributable to the company not being a member of any reinsurance pool as of December 31, 1998. The company had considerably greater leverage on a direct basis than has had before or since on a net basis.

There were two unusual IRIS ratios for 1999. Ratio #2, "Change in Net Premiums Written," of (87)% was unusual because in 1998 the company had a 2.1% participation in the Nationwide Group Pool and in 1999 the company had a 0.4% participation in the Liberty Mutual Group Pool. Ratio #4, "Two-Year Overall Operating Ratio," reflects unsatisfactory underwriting results in both 1998 and 1999.

Financial Experience of Wausau Underwriters Insurance Company

Year	Direct Premiums Written	Net Premiums Written	Premiums Earned	Loss and LAE Ratio	Expense Ratio	Combined Ratio
1995	\$323,745,507	\$ 45,855,932	\$ 45,182,802	86.4%	24.8%	111.2%
1996	327,234,631	202,996,882	166,061,734	86.0	22.7	108.7
1997	272,121,412	170,274,535	167,678,651	77.6	23.4	101.0
1998	290,449,032	116,577,307	150,232,399	93.0	30.7	123.7
1999	289,154,139	14,901,596	27,617,608	92.0	46.5	138.5

Year	Admitted Assets	Liabilities	Surplus As Regards Policyholders	Net Income
1995	\$167,909,312	\$ 95,216,276	\$72,693,036	\$ 4,164,274
1996	378,322,969	305,814,836	72,508,133	(22,283,000)
1997	393,444,700	311,949,288	81,495,412	10,882,219
1998	688,014,912	627,623,888	60,391,024	(15,266,903)
1999	194,149,145	125,495,558	68,653,587	9,327,364

The foregoing charts, summarizing the company's financial experience in recent years, correctly suggest that the company underwent a major change during 1996. Effective January 1, 1996, the company's participation in the Nationwide Group Pool increased from 0.6%

to 2.1%. The pool readjustments led to notable increases in gross premiums written, net premiums written, premiums earned, admitted assets, and liabilities. The net loss of 1996 was occasioned in large part by catastrophic property losses precipitated by Hurricane Fran. The effect that these losses would have had on surplus was partially offset by a parental contribution of \$25,000,000 to gross paid-in and contributed surplus.

The company underwent another major change in 1998 and 1999. Effective December 31, 1998, the company withdrew from the Nationwide Group Pool. As noted earlier, for a brief moment in time coinciding with the close of business on December 31, 1998, the company was not a participant in a reinsurance pool. Liabilities increased because as a participant in the Nationwide Group Pool the company had much higher underwriting leverage on a direct basis than on a net basis. Effective January 1, 1999, WUIC joined the Liberty Mutual Group's reinsurance pool, but with a lower participation percentage than had been the case with the Nationwide Group Pool.

Reconciliation of Policyholders' Surplus

The following schedule is a reconciliation of surplus as regards policyholders between that reported by the company and as determined by this examination.

Surplus as regards policyholders December 31, 1999, per annual statement	\$68,653,587
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	Increase	Decrease	
Common stock	\$	<u>\$140,347</u>	
Federal and foreign income taxes	<u>1,436,070</u>		
Net increase or (decrease)	<u>\$1,436,070</u>	<u>\$140,347</u>	<u>1,295,723</u>
Policyholders' surplus December 31, 1999, per examination			<u>\$69,949,310</u>

Examination Reclassifications

	Debit	Credit
Receivable from parent, subsidiaries and affiliates	\$45,419,344	
Payable to parent, subsidiaries and affiliates		\$45,419,344
Other assets	<u>1,157,921</u>	
Payable to parent, subsidiaries and affiliates		<u>1,157,921</u>
Total reclassifications	<u>\$46,870,966</u>	<u>\$46,870,966</u>

VII. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

There were two specific comments and recommendations in the previous examination report. Comments and recommendations contained in the last examination report and actions taken by the company are as follows:

1. Short-term Investments—It is recommended that the company report the gross amount of interest received on short-term investments in accordance with the format of the convention annual statement.

Action - Compliance.

2. Reinsurance Recoverable—It is recommended that the company establish and maintain a verifiable record of the aging of reinsurance recoverable with sufficient audit trails to permit comparison of annual statement data to specific reinsurance billings.

Action - Noncompliance. Further comment is contained in the section of this report captioned "Reinsurance Recoverable."

Summary of Current Examination Results

Common Stock

The balance of \$1,718,238 reported by the company for this line item included 224,555 common shares of Facility Insurance Holding Corporation. The company reported a market value of \$1 per share, while the Securities Valuation Office set a value of \$0.375 per share on these securities. This resulted in an examination adjustment of \$(140,347) to this line item. This adjustment has been reflected in the section of this report captioned, "Reconciliation of Policyholders' Surplus."

Reinsurance Recoverable

The examination noted certain discrepancies between Schedule F of the 1999 annual statement and the company's aging reports that track reinsurance balances. In some instances, the company listed all balances with respect to a given reinsurance treaty with just one of the numerous participants on a treaty on Schedule F. For example, a reinsurance loss billing report designates New Jersey Re-Insurance Company as the only insurer on reinsurance contract #2101, even though it actually was one of several participants on the contract. It is again recommended that the company establish and maintain a verifiable record of the aging of

reinsurance recoverable, with sufficient audit trails to permit comparison of annual statement data to specific reinsurance billings.

Receivable from Parent, Subsidiaries and Affiliates

The company reported a no balance for this line item as of December 31, 1999, while this examination resulted in a balance of \$45,419,344, due to a reclassification of a contra-liability account representing net balances receivable from Employers from the line item for "Payable to Parent, Subsidiaries and Affiliates." While it is acceptable to offset receivable and payable balances with respect to the same affiliate, it is unacceptable to offset amounts payable to one affiliate by amounts receivable from another affiliate for annual statement reporting purposes. This reclassification is reflected in the section of this report captioned, "Reconciliation of Policyholders' Surplus per Examination." It is recommended that the company discontinue the practice of offsetting affiliated balances of different companies.

Other Assets

The balance of \$154,500 reported by the company for this line item consisted mostly of items allocated to the company through the Liberty Mutual Group reinsurance pooling. The examination increased the balance for this line item by \$1,157,921 to \$1,312,421. The examination reclassified a receivable balance from Colonial County Mutual Insurance Company in the amount of \$1,157,921 to this line item from the line item for "Payable to Parent, Subsidiaries and Affiliates," because Colonial County Mutual Insurance Company was not an affiliate as of December 31, 1999. This reclassification is reflected in the section of this report captioned, "Reconciliation of Policyholders' Surplus."

Losses and Loss Adjustment Expenses

Since January 1, 1999, the company has been a participant in a reinsurance pooling agreement with Liberty Mutual Insurance Company and certain of its property and casualty insurance subsidiaries and other affiliates. The company's net loss and loss adjustment expense reserves are the product of the reserves of the Liberty Mutual Group Pool and the company's participation percentage in the pool.

As part of its engagement by the Massachusetts Division of Insurance to assist in the overall examination of Liberty Mutual Insurance Company and Liberty Mutual Fire Insurance Company, PricewaterhouseCoopers LLP reviewed the adequacy of the company's loss reserves and loss adjustment expense reserves, including the provisions for environmental claims, as a function of its participation in the pool.

The review was conducted in a manner consistent with the Code of Professional Conduct and the Qualification Standards of the American Academy of Actuaries and the Standards of Practice adopted by the Actuarial Standards Board.

The results of PricewaterhouseCoopers LLP's actuarial review indicated that the company's reserves at December 31, 1999, made an adequate provision for all unpaid loss and loss adjustment expense obligations of the company under the terms of its policies and reinsurance agreements.

Other Expenses

This line item represents incurred but unpaid other underwriting and investment expenses, excluding taxes, licenses and fees. The company reported a balance for this line item of \$941,212 as of December 31, 1999.

For a company within a holding company system of the size and complexity of the Liberty Mutual Group, the line item for "Other Expenses" consists of numerous accruals that can be made only through careful estimation in good faith. This examination conducted an extensive review of the accruals that comprised the line item for "Other Expenses" and determined that the company's estimates were reasonable overall. Omissions to accrue and under-accrual of executive compensation and benefit plans was the only exception to the overall reasonableness of the company's estimation procedures. The substantive effect of these omissions and under-accruals was not material, but the company should address this situation. It is recommended that the company estimate its liabilities with respect to each executive compensation and benefit program and record such estimates on future statutory financial statements.

Federal and Foreign Income Taxes

This line item represented the company's estimate of federal and foreign income tax payable that was allocable to it under Liberty Mutual Group's consolidated federal income tax policy. The company reported a balance for this line item of \$(1,436,070) as of December 31, 1999, while this examination resulted in a balance of \$0. The examination made this adjustment, which had the effect of increasing surplus by \$1,436,070, simply to reflect the difference between the updated estimate available at the time of examination fieldwork and the amount carried on the 1999 annual statement. The balance payable for federal and foreign income taxes was zero because the company reported federal income tax losses for 1999. Under the Liberty Mutual Group's consolidated federal income tax policy, the company was not eligible to realize a benefit from these tax losses until it subsequently experienced positive taxable income. This adjustment is reflected in the section of this report captioned, "Reconciliation of Policyholders' Surplus."

The examination noted that the company did not have a formally executed tax allocation agreement. A policy statement entitled "Draft # II – Liberty Mutual Group Tax Sharing Arrangement" was drafted on July 30, 1990, but never finalized and executed. The companies within the Liberty Mutual Group consistently follow an informal arrangement that approximates the terms of the draft agreement except that detailed separate company tax calculations, such as calculation of the alternative minimum tax on a separate company basis, are not always performed at the time of the tax provision. Instead, for provision purposes, each company is charged the tax effect of their regular taxable income at the time of the provision. The company has since executed a tax allocation agreement, which was approved by the OCI. Therefore, a recommendation on this subject is unnecessary for purposes of this examination report.

Provision for Reinsurance

On March 25, 1999, OCI issued a permitted practice decision whereby the company may regard the Nationwide Indemnity Company treaty as satisfactory security with regard to the calculation of the Schedule F statutory penalty on authorized and unauthorized reinsurance recoverables covered by the treaty. This decision succeeded one dated December 28, 1998, whereby relief on the provision for reinsurance was limited to unauthorized reinsurance

recoverables covered by the treaty with Nationwide Indemnity Company. Both permitted practice decisions were conditioned upon disclosure of the permitted practice in a note to each statutory financial statement issued by the company, together with a statement in this disclosure indicating the financial impact of the permitted practice. The disclosure upon which these permitted practice decisions were conditioned was not made in the 1999 annual statement.

The company's accounting procedures with respect to external reinsurance have changed to provide that WUIC cessions to non-affiliated reinsurers are no longer reported on an individual company basis. WUIC now cedes its net results to Employers Insurance Company of Wausau, which accounts for external reinsurance specific to the Wausau Insurance Companies prior to the cession to Liberty Mutual Insurance Company. Therefore, the previous examination report's recommendation need not be repeated.

Payable to Parent, Subsidiaries and Affiliates

The company reported a balance for this line item of \$(45,825,971) as of December 31, 1999, while this examination resulted in a balance of \$(92,403,236). The difference is summarized as follows:

Balance per company		\$(45,825,971)
Reclassifications:		
Reclass to "Other Assets"	\$ (1,157,921)	
Reclass receivable balance to "Receivable from Parent, Subsidiaries and Affiliates"	(45,419,344)	
Net reclassifications per examination		<u>(46,577,265)</u>
Balance per examination		<u>\$(92,403,236)</u>

The examination reclassified a general ledger account from this line item to "Other Assets." This reclassification is reflected in the section of this report captioned, "Reconciliation of Policyholders' Surplus." The circumstances of this reclassification have been described in the section of this examination report captioned, "Other Assets."

The examination reclassified \$45,419,344 in a contra-liability account representing net balances receivable from Employers from this line item to "Receivable from Parent, Subsidiaries and Affiliates." This reclassification is reflected in the section of this report captioned, "Reconciliation of Policyholders' Surplus." The circumstances of this reclassification

have been described in the section of this examination report captioned, "Receivable from Parent, Subsidiaries and Affiliates."

Subsequent Events

Since the conclusion of fieldwork on October 20, 2000, there have been a number of noteworthy developments with respect to the company's holding company system and management and control.

Mutual Holding Company Restructuring

In 2000, Liberty Mutual Insurance Company filed an application to restructure under a mutual holding company plan pursuant to the laws of the Commonwealth of Massachusetts. The laws of both Massachusetts and Wisconsin allow a mutual insurance company to convert to a stock insurance company by placing the mutual policyholders' ownership rights in a mutual holding company, which then becomes the owner of the newly-converted stock insurance company. On November 9, 2001, Liberty Mutual's policyholders approved the reorganization of their company into a mutual holding company structure, and on November 27, 2001, Massachusetts' Commissioner of Insurance approved the reorganization. On November 28, 2001, Liberty Mutual became a stock corporation under the control of Liberty Mutual Holding Company Inc., which contributed all of the issued and outstanding common shares of Liberty Mutual to LMHC Massachusetts Holdings Inc., which, in turn, contributed this stock to Liberty Mutual Group Inc. In this manner, Wausau General Insurance Company became a fifth-tier subsidiary of Liberty Mutual Holding Company, Inc.

Employers pursued a mutual holding company restructuring under the laws of the state of Wisconsin in tandem with the efforts of Liberty Mutual. Employers filed an application dated September 15, 2000, to restructure under a mutual holding company plan pursuant to ch. 644, Wis. Stat.

On November 9, 2001, OCI approved Employers' mutual holding company plan. On November 21, 2001, Employers converted to a stock corporation and was renamed "Employers Insurance Company of Wausau." one day after the affirmative vote of its policyholders.

Employers became a direct, wholly owned subsidiary of Employers Insurance of Wausau Mutual Holding Company.

On March 14, 2002, the members of Liberty Mutual Holding Company, Inc. voted to approve a merger of Employers Insurance of Wausau Mutual Holding Company with and into Liberty Mutual Holding Company, Inc. This merger was consummated on March 19, 2002.

Current Board of Directors

There have been certain changes to the board of directors since the end of examination fieldwork on October 20, 2000. As of December 5, 2002, the board of directors consisted of the following persons:

Name and Residence	Principal Occupation	Term Expiry
J. Paul Condryn III Walpole, Massachusetts	Senior Vice President and Chief Financial Officer Liberty Mutual Insurance Company	2004
Terry L. Conner Rye, New Hampshire	Senior Vice President and Chief Information Officer Liberty Mutual Insurance Company	2005
A. Alexander Fontanes Duxbury, Massachusetts	Senior Vice President and Chief Investment Officer Liberty Mutual Insurance Company	2005
Joseph A. Gilles Wausau, Wisconsin	President and Chief Operating Officer EMPLOYERS INSURANCE OF WAUSAU A Mutual Company	2005
Gary R. Gregg Milton, Massachusetts	Executive Vice President Liberty Mutual Insurance Company	2003
Edmund F. Kelly Weston, Massachusetts	President and Chief Executive Officer Liberty Mutual Insurance Company	2004
Christopher C. Mansfield Dedham, Massachusetts	Senior Vice President and General Counsel Liberty Mutual Insurance Company	2003

Current Officers

There have been significant changes in officers since the end of examination fieldwork on October 20, 2000. As of December 5, 2002, the following persons served as officers of the company:

Name	Office/Position
Edmund F. Kelly	Chairman of the Board and Chief Executive Officer
Gary R. Gregg	Vice Chairman of the Board
Joseph A. Gilles	President and Chief Operating Officer
J. Stanley Hoffert	Vice President, General Counsel and Secretary
Juliana M. Coyle	Vice President and Treasurer
Robert D. Effinger	Vice President, Actuarial and Underwriting Products and Services
Martin J. Welch	Senior Vice President and Manager
Scott W. Hogan	Chief Financial Officer
J. Eric Brosius	Vice President and Manager, Domestic Reinsurance
Jeffrey R. Cole	Vice President and Manager, Custom Accounts
George W. Doonan	Vice President, Commercial Finance
Dexter R. Legg	Vice President and Assistant Secretary
Gary J. Ostrow	Vice President, Corporate Taxation
Paul A. Rodliff	Vice President
W. Craig Olafsson	Assistant Vice President, Counsel and Assistant Secretary
Diane S. Bainton	Assistant Secretary
James Pugh	Assistant Secretary
Lawrence H. S. Yahia	Assistant Secretary
Richard C. Cloran	Assistant Treasurer

VIII. CONCLUSION

Policyholders' surplus has decreased from \$72,508,133 as of year-end 1996, to \$69,949,310 as of year-end 1999, as adjusted by this examination. This represents a decrease of 4% during the period under examination.

The following schedule summarizes the cumulative increases and decreases to surplus from December 31, 1996, when policyholders' surplus was last verified by examination, to December 31, 1999:

Policyholders' surplus, December 31, 1996	\$ 72,508,133
Other surplus items	(10,899,106)
Net income	4,942,680
Accounts payable	1,423,592
Net financial examination adjustments	
as of December 31, 1999	1,295,723
Change in nonadmitted assets	1,140,155
Change in excess of statutory reserves	
over statement reserves	537,000
Change in provision for reinsurance	(534,559)
Discontinued business surplus adjustment	(464,024)
Change in accumulated translation adjustment	(5,262)
Net unrealized capital gains or (losses)	<u>4,978</u>
Policyholders' surplus, December 31, 1999	<u>\$69,949,310</u>

Areas of improvement recommended by this examination included, but were not limited to, reporting liabilities for executive compensation and benefit plans, maintenance of audit trails in reinsurance accounting, and reconciliation of equities and deposits in pools and associations.

While the company is a separate legal entity, it derives all of its net retained business through a pooling arrangement with certain affiliates led by Liberty Mutual Insurance Company. All of the company's operations are conducted by employees of WSC and Liberty Mutual, and the results of WUIC's operations, other than investments and taxes, are pooled with participants in the Liberty Mutual Group Pool. The experience of the company relative to net premiums, liabilities, and net underwriting results will follow the experience of the affiliated pool. Therefore,

the practices and procedures of pool participants, especially Liberty Mutual, which manages the pool, are critical to the operating results of the company.

IX. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 36 - Reinsurance Recoverable—It is again recommended that the company establish and maintain a verifiable record of the aging of reinsurance recoverable, with sufficient audit trails to permit comparison of annual statement data to specific reinsurance billings.
2. Page 37 - Receivable from Parent, Subsidiaries and Affiliates—It is recommended that the company discontinue the practice of offsetting affiliated balances of different companies.
3. Page 38 - Other Expenses—It is recommended that the company estimate its liabilities with respect to each executive compensation and benefit program and record such estimates on future statutory financial statements.

X. ACKNOWLEDGMENT

The courtesy and cooperation extended during the course of the examination by the officers of the company and employees of Wausau Service Corporation and Liberty Mutual Insurance Company is acknowledged.

In addition to the undersigned, the following representatives of the Office of the Commissioner of Insurance, state of Wisconsin, participated in the examination:

Name	Title
Andrew M. Fell	Financial Examiner
David A. Grinnell	Financial Examiner
Steven F. Harwick	Financial Examiner
Mark A. Lasowski	Financial Examiner
Cruz J. Flores	Senior Insurance Examiner, Electronic Data Processing Audit Specialist
Frederick H. Thornton	Senior Insurance Examiner, Exam Planning & Quality Control Specialist

Respectfully submitted,

Steven J. Junior
Examiner-in-Charge